



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

29 May 2007

Our ref: ICAEW Rep 42/07

Your ref:

The International Accounting Standards Committee
30 Cannon Street
London
EC4M 6XH
United Kingdom

By email: commentletters@iasb.org

Dear Sir

**IASB EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 24 RELATED
PARTY DISCLOSURES: STATE-CONTROLLED ENTITIES AND THE DEFINITION OF
A RELATED PARTY**

The Institute of Chartered Accountants in England and Wales ('the Institute') is pleased to respond to your request for comments on the Exposure Draft of Proposed Amendments to IAS 24 *Related Party Disclosures: State-Controlled Entities and the Definition of a Related Party*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours faithfully

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ICAEW Representation

ICAEW REP 42/07

RELATED PARTY DISCLOSURES - STATE-CONTROLLED ENTITIES AND THE DEFINITION OF A RELATED PARTY

Memorandum of comment submitted in May 2007 by The Institute of Chartered Accountants in England and Wales, in response to the Exposure Draft of Proposed Amendments to IAS 24 Related Party Disclosures - State-controlled Entities and the Definition of a Related Party, published by the International Accounting Standards Board in February 2007.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the Exposure Draft of Proposed Amendments to IAS 24 Related Party Disclosures - State-controlled Entities and the Definition of a Related Party, published by the International Accounting Standards Board in February 2007.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

MAJOR ISSUES

Overall response

4. We support the Board's intention to provide exemption from related party disclosures by state-controlled entities where no influence has been exercised, and to improve the definitions in the standard. We welcome the fact that the standard and the proposals are principles-based. Our detailed comments are set out below.

State-controlled entities

5. Paragraph 17A aims to exempt a reporting entity from disclosing related-party transactions with an entity if it is only related to that entity by virtue of them both being controlled by the same state, and no actual influence is exercised. We read this as otherwise requiring disclosure of all transactions between those entities, even if they were carried out on an arms length basis. Although what is of interest to users is disclosure of actual transactions that have been carried out on a non-arms length basis as a result of state influence, we agree that where influence has been exercised, all related party transactions between the two entities should be disclosed.
6. Where paragraph 17A(b) states that there must be 'no indicators that the reporting entity influenced, or was influenced by, that entity', we suggest that the words 'or by the state in relation to that entity' should be added. This will bring paragraph 17A(b) into line with paragraph 17C, which refers specifically to 'direction or compulsion by a state'. Clearly, if a state-controlled entity engages in a non-arms length transaction with another state-controlled entity as a result of intervention by the state, the relevant information is useful to users and available to the reporting entity.

7. We believe that it is clear that the exemption in paragraphs 17A - 17E is applicable only to entities, not individuals. For example, if the spouse of a key management personnel (KMP) is contracted to the entity, then the arrangement is disclosable. We suggest that this could be made clear in the Basis for Conclusions. It may also be necessary to consider defining 'an entity' in this context.

Proposed definitions

8. We support the Board's proposed changes to the definition of a related party; namely:
- (a) to ensure that an associate and a subsidiary of an entity are related parties for the purposes of their individual, or separate, financial statements;
 - (b) where an entity is significantly influenced by a person, and another entity is significantly influenced by a close member of the family of that person, to no longer consider the two entities to be related. We agree that it is desirable to achieve consistent treatment of all associates, and that this is the best solution; and
 - (c) where an investee of Key Management Personnel is treated as a related party in the reporting entity's financial statements to require it to be also treated as a related party in the investee's own financial statements. We agree that this reciprocity of treatment is desirable.
9. The new definition of 'close members of the family of a person' no longer includes the word 'may' in reference to the list of close family members. The effect of this appears to be to *require* the listed family members to be treated as related parties, in place of the rebuttable presumption that previously obtained. We do not agree that the rebuttable presumption should be removed in this way without consultation about whether the list is complete or not, for example it might be extended to include parents (who would be expected to influence their children). This seems to us to be an incompletely thought out amendment. At the very least, the change in drafting leaves it unclear as to whether the rebuttable presumption has been removed or not in relation to the list; we have heard diverging views on the question, which tends to indicate ambiguity.
10. We suggest that revised paragraph (a) of the definition of a related party, which reads
- 'A person or a close member of the family of that person is related to a reporting entity if either person:'
- should be amended to read:
- 'A person and all close members of the family of that person are related to a reporting entity if that person:'
11. Although it is not proposed to change the reference to 'significant voting power' in (b)(vi) and (b)(vii), we think the Board might take this opportunity to add some explanation about what it means. Presumably it is something that falls short of significant influence, but it is not clear whether it is aiming for voting rights of above 20% where significant influence has been rebutted, or some holding lower than this.

Other issues

12. The nature of the changes envisaged in this exposure draft highlights the need for specific guidance on materiality in IAS 24. The standard should explicitly state that disclosure is required of material related party transactions and give more guidance on materiality in the context of such transactions, with particular reference to materiality from the perspective of either related party and the qualitative considerations that are arguably more important than quantitative factors in these cases. The discussion in paragraph 20 of UK FRS 8 *Related party transactions* indicates that the materiality of related party transactions is to be judged not only in the broader context of the reporting entity but also in relation to an individual related party; eg, where that party is a director, key manager or some other accountable person.
13. Revised paragraphs 17 and 20 of the standard add a requirement for information about 'commitments' to be disclosed. We would expect such information to be already captured by existing requirements, such as those in respect of post balance sheet events and narrative reporting. It would be helpful if paragraph BC 23 could be more expansive in explaining the import of this new requirement.
14. Paragraph 16 of IAS 24 (not reproduced in the ED) requires the disclosure of key management compensation by categories that reflect the IAS 19 categories plus share-based payment. Although the intention of a related party standard should be to disclose here the benefits received by the key management personnel, the layout of 24.16, and the requirement for a total to be given, implies that the IAS 19/IFRS 2 expenses should be disclosed instead. The issues of corridors and past service costs, and values of share awards, etc, make these requirements somewhat difficult to interpret. We believe it would be helpful, while clarifying other aspects of IAS 24, to clarify the intended disclosures under this paragraph.

SPECIFIC QUESTIONS

Question 1 – State-controlled entities

- (a) **Do you agree with the proposal to provide, in the circumstances described in this exposure draft, an exemption for entities controlled or significantly influenced by the state?**

If not, why? What would you propose instead and why?

15. We agree. We suggest a drafting amendment to paragraph 17A(b) as noted in paragraph 6 above, to bring it into line with paragraph 17C.

- (b) **Do you agree:**

- (i) **that an indicator approach is an appropriate method for identifying when the exemption should be provided for entities controlled or significantly influenced by the state; and**
- (ii) **that the proposed indicators are appropriate?**

If not, why? What would you propose instead and why?

16. We agree that an indicator approach is appropriate. However, we have some difficulty understanding why (b) and (c) would be indicators of influence being exercised: indicator (a) seems the only relevant one in that the fact it is at non-market rates is what is unusual and indicative of the exercise of influence (otherwise it would presumably be at market rates). A mere sharing of resources or undertaking of an economically significant transaction would seem unlikely to indicate influence is being exercised. We suggest replacing (b) with 'undertake transactions which are not of economic benefit to one or other party'. We also wonder whether what (c) is aiming for is the identification of transactions which are economically (and possibly politically) significant for the *state* (i.e. not just the entities involved) and that the text should be redrafted along these lines.

Question 2 – Definition of a *related party*

- (a) **The definition of a related party in IAS 24 does not include, for a subsidiary's individual or separate financial statements, an associate of the subsidiary's controlling investor. The Board has decided that it should be included, and thus proposes to amend the definition of a related party. The Board similarly proposes that when the investor is a person, entities that are either significantly influenced or controlled by that person are to be treated as related to each other. Do you agree with this proposed amendment?**

If not, why? What would you propose instead and why?

17. We agree

- (b) **IAS 24 does not define associates of an *entity* as related parties. However, when a *person* has significant influence over an entity and a close member of the family of that *person* has significant influence over another entity, IAS 24 defines those two entities as related parties. The Board proposes to align the definition for both types of ownership by excluding from the definition of a related party an entity that is significantly influenced by a person and an entity that is significantly influenced by a close member of the family of that person. Do you agree with the proposed amendment?**

If not, why? What would you propose instead and why?

18. We agree.

- (c) **IAS 24 defines any entity over which a member of the key management personnel of the reporting entity has control, joint control or significant influence, or in which the member holds significant voting power, as related to the reporting entity. However, the converse is not true. Thus, when the entity that a person controls, jointly controls or significantly influences, or in which the person has significant voting power, is the reporting entity and that person is a member of the key management personnel of another entity, that other entity is not defined as related to the reporting entity. The Board proposes to remove this inconsistency by expanding the definition to encompass both situations. Do you agree with the proposed amendment?**

If not, why? What would you propose instead and why?

19. We agree.

- (d) **Do you agree with the proposal to clarify the definition of a related party? Does the wording proposed capture the same set of related parties as IAS 24 at present (except for the amendments described in (a) - (c) above)? Do you agree that the proposed wording improves the definition of a related party?**

If not, why? What would you propose instead and why?

20. We agree the current wording of the definition is difficult to follow and improvements should be made. However, we suggest it might be made even clearer and further attempts at redrafting should be made. For example, one suggestion is along the following lines:

- (a) A person is a related party of a reporting entity if that person:
- (i) is a member of Key Management Personnel ...
 - (ii) has control over the reporting entity ...
 - (iii) has joint control over the reporting entity ...; or
 - (iv) is a close member of the family of any person in (i)-(iii) above.
- (b) An entity is a related party of a reporting entity if ...'

We understand that other suggestions are being made by respondents and we suggest that, as the redrafted definition is still quite hard to follow, it would be worthwhile to consider the best of these suggestions.

Question 3 – Definition of *related party transactions*

Do you agree with the proposal to clarify the definition of a related party transaction?

If not, why? What changes would you propose and why?

21. We are content with the revised definition of a related party transaction. See paragraph 9 above for our comments on changes to the definition of 'Close members of the family of a person'.

Question 4

Do you have any other comments on the proposals?

22. As set out in paragraphs 12 and 13 above, we would welcome a discussion on materiality in the context of related parties; and we do not understand the need for the addition of a specific requirement for information about 'commitments' to be disclosed.

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